



DEPARTMENT OF THE TREASURY OFFICE OF PUBLIC AFFAIRS

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**HEARING TESTIMONY
THE HONORABLE JOHN W. SNOW
SECRETARY OF THE TREASURY
ON REFORM OF THE UNITED STATES POSTAL SERVICE
BEFORE A JOINT SESSION OF THE
COMMITTEE ON GOVERNMENT REFORM
UNITED STATES HOUSE OF REPRESENTATIVES
AND
COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE
MARCH 23, 2004**

Chairman Collins, Chairman Davis, Ranking Member Lieberman, Ranking Member Waxman and distinguished members of the House and Senate Committees, thank you for the opportunity to testify today on the need for comprehensive postal reform. I welcome this opportunity to underscore the Administration's interest to support a principled approach to enacting comprehensive legislation to reform the United States Postal Service.

The Postal Service's Important Role in America's Economy and Life

The operations of the Postal Service touch virtually every individual in every American household. In many ways, the Postal Service serves as a sort of "human face" of the federal government. It performs a critical service, and it performs it well. I also recognize that the USPS is an enormous business, focusing on sorting, transportation, and delivery on a massive scale. As one of the largest businesses in America, the operational challenges connected with this organization are many. I also bear in mind that the Postal Service provides careers for more than 700,000 individuals. As its most valuable assets, issues connected with the Postal Service's labor force must be carefully considered. Finally, as has been frequently pointed out in the past, the Administration's focus on the

Postal Service has a much wider application in our country's economy. While important in and of itself, some industry estimates associate the Postal Service with a much larger mailing industry – estimated to be a \$900 billion industry, employing 9 million workers and responsible for as much as 8% of the GDP.

It is widely acknowledged that the current business model of the Postal Service is not sustainable going into the 21st century. Electronic diversion of mail volumes has caused a substantial and likely irreplaceable decline in first class mail. This trend is expected to continue. The Postal Service ended the latest fiscal year with large on and off-balance sheet liabilities. These liabilities include \$7.3 billion of debt owed to Treasury, \$7.1 billion for unfunded workers' compensation costs, \$8.7 billion for operating leases, \$5.8 billion for unfunded pension liabilities, and approximately \$60 billion for unfunded post-retirement healthcare liabilities. For a business that has a statutory mandate to be self-financing and to break-even, the Postal Service has accomplished neither.

The Administration's Response

The Administration has already demonstrated clear support for comprehensive postal reform. To his credit, President Bush took the initiative to create a bipartisan Commission to examine what steps might be taken to put the Postal Service on a sound financial and operational footing well into the 21st century. In the short seven month period of time provided to the Commission by the President, the Commission submitted a report containing 35 recommendations that spanned a wide variety of areas, which is a critical building block to achieve postal reform.

It is worthy to note that the 16 out of the 35 recommendations are assigned to the Postal Service for immediate action. This is evidence that there is wide latitude already provided to the Postal Service, according to relevant statutes, to operate in a manner that will result in ever better operational and financial performance.

However, there are many important recommendations of the Commission that will require Congressional action. I wish to give credit to you, Chairman Collins and Chairman Davis, as well as to your colleagues, in particular Congressman McHugh, for dedicating an abundance of time and effort in conducting public hearings and seeking an optimal approach to legislative change that is clearly urgently needed. Your leadership is critical to a successful next step in reforming the Postal Service.

I want to reiterate the Administration's goal to support a comprehensive postal reform act during 2004 that is characterized by the five principles articulated by the White House last December: implement best practices; enhance transparency; provide for greater operating flexibility; foster greater accountability; and ensure self-financing. I note with some pleasure that these five principles are widely endorsed by members of these committees, the Postal Service, and by the many stakeholders in the mailing community. Following its review of written testimony and other public comments, the Administration has great confidence that there is broad, general, consensus in the diverse stakeholder community on what elements of reform are "must haves."

Rather than discuss a wide range of issues today, I would like to focus my testimony on three particular issues that, having reviewed the testimony of previous hearings in the House and Senate, are matters of great interest to the Administration: allocation of Civil Service Retirement System (CSRS) military costs; considering the break-even mandate; and cost allocation.

Ensuring Self-Financing

CSRS Funding Reform: Allocation of Military Costs

The Administration believes that comprehensive postal reform must require the Postal Service to cover all of its financial obligations, including its on and off-balance sheet unfunded liabilities, as well as other liabilities. This is consistent with the requirement that the Postal Service be self-financing and ensures that the Postal Service will remain motivated to operate in a manner that strengthens the financial and operational health of the Postal Service. Taxpayer bailouts should not be the future of the Postal Service.

Public comments by some members of Congress and others in the mailing community with respect to reversing the current allocation of pension costs for military service in the Postal Civil Service Retirement System Funding Reform Act of 2003 (hereafter “the Postal CSRS Funding Reform Act”), P.L. 108-18, suggest that further clarity on the Administration’s intent is warranted.

While this is, indeed, a complicated topic, I believe it is important to comment on it because the Administration adopted the principle of “ensuring self-financing” with this particular issue very much in mind. To its great credit, the Congress enacted the Postal CSRS Funding Reform Act quickly and crafted it appropriately with respect to attributing military costs. The Administration opposes any effort to shift the estimated \$27 billion of military costs back to the taxpayer.

The decision to allocate retirement costs connected with military service to the Postal Service is justified by three principled arguments: this is a fair and equitable allocation of costs, it represents good government, and it is financially prudent. Each argument, by itself, is compelling. Taken together, this is a persuasive set of arguments that serves to endorse the original decision of Congress in the Postal CSRS Funding Reform Act.

As a starting point, it is important to note that no other federal agency has ever received the benefit of a dynamic analysis of its investment flows, as was the case for the Postal Service. It provided the Postal Service with a properly calculated, enormous gain of \$78 billion at the expense of other CSRS participants.

Fair and Equitable

This allocation is fair and equitable because the Postal Service, as mandated in the Postal Reorganization Act signed in 1970, is obliged to manage its finances in a manner that ensures that it covers its costs, unlike virtually all other federal agencies. Furthermore, it

is fair and equitable because the Postal CSRS Funding Reform Act created a funding system, akin to the funding system currently utilized for the Federal Employee Retirement System (FERS), which requires each agency to cover pension costs connected with military service (rather than Treasury). Finally, it is fair and equitable because the Postal Service has also been the beneficiary of significant taxpayer funded appropriations, which more than cover the attribution to Postal of the \$27 billion of military costs. During a period when the Postal Service has a statutory mandate to be self-financing, the Postal Service's cumulative performance has been bolstered enormously and in an extraordinary way by taxpayers, and as a direct benefit to ratepayers.

Good Government

The Postal CSRS Funding Reform Act provides us with a postal pension methodology grounded in pension funding principles that are characterized as "best practices." This is a "good government" initiative. The new system replaced a system of funding postal pensions that Congress developed in a piecemeal fashion, and which never conformed to good funding principles. With Congressional leadership in the Postal CSRS Funding Reform Act, we adopted a system to drive full funding for FERS and full funding for postal CSRS.

There are a number of voices that advocate a return of these obligations to the taxpayer because the impact on the federal budget deficit can be minimized by having the Postal Service allocate these funds to cover other currently unfunded retirement obligations. Choosing to emphasize a negligible net budgetary impact rather than concentrating on the fact that real economic costs are being transferred from ratepayers to taxpayers can serve to cloud the fundamental issue. Good government dictates that we consider this as a real economic cost, dollar for dollar, no matter how these funds might be accounted for in the federal budget.

In short, last year's legislation was never intended to put the Postal Service in the same situation as other federal agencies, and we ought not to try to do that now, either. Rather, it was an appropriate "good government" response to an alternative funding methodology brought to our attention. It was not intended as a "break" for the Postal Service, or to provide the Postal Service a discount from their real costs.

Financially Prudent

This issue is best considered in the wider context of the federal government's retirement funding system. Choosing to treat the Postal Service in a manner that is inconsistent with the FERS funding paradigm has implications to the wider government retirement structure. By so doing, the door is opened to tinker with FERS across agencies, as it will be difficult to conclude that the Postal Service is the only exception to an otherwise consistent retirement system. The costs are likely to be enormous in their entirety.

The Escrow Provision in the CSRS Funding Reform Act

With respect to the Postal CSRS Funding Reform Act's provision establishing an escrow account, it is important to note that the Administration never advocated including this provision in the final bill. The Administration is willing to work toward a proposed modification of the Postal CSRS Funding Reform Act abolishing the escrow that will not increase the deficit.

Ensuring Self-Financing The Break Even Mandate

We find recent statements claiming that the Postal Service is nearly at a financially break-even position as mandated by the Postal Reorganization Act to be somewhat misleading. By limiting its analysis to the reported accounting results, the Administration could agree that the cumulative losses in the Postal Service's retained earnings account might be covered by the end of this fiscal year (thanks to the Postal CSRS Funding Reform Act).

However, we would argue that a more accurate assessment of the Postal Service's financial performance should also include taking into account unfunded liabilities it has incurred but may or may not be included on its balance sheet, as well as all taxpayer-funded appropriations received. While the Postal Service's audited financial statements show that it has lost \$2.2 billion in the 1972-2003 period, when overlayed with the unfunded liabilities and taxpayer-funded appropriations, the Postal Service has suffered real economic losses in excess of \$101 billion.

Revenue and Cost Allocation

I would also stress the importance of precise revenue and cost allocation across products as a key element to include in any successful postal reform. We do not believe that the current ability of the Postal Service to allocate costs across products to a 58% tolerance level, thus attributing approximately 42% of total costs to general overhead, is close to being satisfactory. In our view, this large unallocated portion is a sort of "elephant in the room" that forces stakeholders, employees, competitors, the regulator, Board of Governors, USPS management and others to invest substantial time, energy, and expense calculating, debating or contemplating a myriad of important issues. While we recognize cost attribution can be complicated for a company the size and complexity of the Postal Service, we do not agree with those who contend that it is not possible to drill down to a much finer cost allocation.

In the case of the Postal Service, the public interest and trust demands the level of transparency and accountability that we are calling for. We do not believe that confidentiality concerns of the private sector should be applied to the Postal Service. On the contrary, in fact, the scope of postal reform requires true and exacting transparency.

Conclusion

The Congress has a unique opportunity during the next months to take decisive action to craft a comprehensive postal reform bill that can be instrumental in helping the USPS operate more successfully. Thank you for the attention you are paying to this critical aspect of our country's economy and life. We continue to appreciate and endorse the effort and dedication that the Postal Service's employees, management, and Board of Governors invest into implementing its Transformation Plan and those recommendations posited by the President's Commission on the United States Postal Service. The Administration remains prepared to actively work with you to craft a comprehensive reform bill that will stand the test of time in an enormously dynamic market. We believe it critical that reform legislation result in a sharing of sacrifice from all stakeholders, and characterized by the five principles we have articulated.

Once again, I thank you for your kind invitation to appear today. I would be grateful if you would direct your questions to Acting Under Secretary for Domestic Finance, Brian Roseboro, who will be pleased to respond.